Gearing Up for the Apartment Revenue Management Conference

In advance of the 2013 Apartment Revenue Management Conference, September 23-25 at the Turnberry Isle Resort in Miami, several top rental housing professionals offer insight into the capabilities and opportunities created by revenue management.

All Revved Up

Revenue management works—but how?

Since the early 2000s, companies have shown that applying revenue management techniques to the apartment business consistently boosts rental revenue by 2 percent to 5 percent. "Our leasing team has improved our occupancy by 4 percent or 5 percent over the typical market in this area, and we experienced rent growth of at least 6 percent to 7 percent over the last year," says Mark Jones, Chief Financial Officer for Fairfax, Va.-based apartment management company A.J. Dwoskin.

Adds Julie Manthey, Vice President of Operations, Western National Property Management, "We use revenue management tools to assist with training our teams on how to better sell with higher skill levels of negotiations for closing benefits."

While these results are impressive, a deeper understanding of the algorithms and logic behind the revenue management models has been elusive in the industry. All too often, decision-makers have been content to allow these systems to make decisions without understanding the processes and data points responsible for the outputs. Consequently, when recommended prices don't match expectations, they get overridden or approved without analysis; either can be a detriment to property operations.

Yet, the human element is often the critical factor in the success of any revenue management solution. By understanding the process by which revenue management systems recommend prices, decision-makers can better understand those recommendations and determine whether a given price is in the best interest of the property, or in fact is the product of bad data, bad practices or a bad model.

Poor operating results often stem from property-specific issues such as training or deferred maintenance. In those cases, revenue management systems have only one option: lower rents. Eventually, if the core problem is not resolved, rents will get low enough to lease apartments. By that time, the quality of the renter may have declined, leading to still more turnover and still lower rents.

The major revenue management solutions in the apartment industry use one of three models to optimize rent: Mathematical Optimization, Market Modeling or the Expert System (Artificial Intelligence). All three take into consideration supply (vacant units, units on notice and lease expirations) and demand (traffic trends, lease applications and conversion ratios). How they respond to changes in these indicators and their algorithms is slightly different for each.

Mathematical Optimization takes advantage of linear and nonlinear methods to define the best possible price given a set of assumptions (such as average turn costs) and constraints (such as minimum acceptable occupancy). This approach should track closely against the broader benchmark of rents in a given region, but doesn't factor environmental considerations, such as news of a major company opening near a community, or property characteristics like a dated clubroom. In time, the impact of an environmental change will affect the broader market and the mathematical optimization model will take its influence into account. Apart from manual adjustments, however, these models cannot account for property-specific characteristics.

Market Modeling uses a "market-data" methodology based on economic trends and the competitive landscape. It assigns greater weight to market forces than the optimization model and is less likely to produce counter-intuitive prices. Rent recommendations are based on economic data about the region as well as knowledge of the property's competitors. This method will also produce recommendations in-line with the overall market. Market Modeling engines can be adjusted for intrinsic characteristics of a property, but it can be difficult to readjust them later.

As an example, if a property has the top leasing consultant in the company and has consistently achieved higher rents than its market, the market model will take that into account. But if that associate leaves, the model will need to be adjusted to continue to produce optimum results.

Expert Systems, also called Artificial Intelligence, attempt to emulate the decision-making process of revenue managers, but with fewer biases than actual people. Because its algorithm correlates rent increases with leasing velocity, even if a property's rents are higher than the competitive set, as long as it continues to lease units, the engine will keep recommending higher rents. This allows the model to produce higher-than market returns based on each property's unique characteristics. Because the engine also incorporates the asset's own operating history and seasonality, its results take into account the unique features of the property.

Jones, who uses the expert system, is pleased with its performance.

"It has given our leasing consultants and property management team a tool and confidence in our asking rents," he says. "They can improve their closing ratios on renewals and new leases while achieving a certain price depending on occupancy or traffic. The data collected by the expert system really helps us focus on securing all possible leases."

All of these methodologies have pros and cons, and all three models have proven themselves to work; however, the key to any successful revenue management program is determining your strategy first. Are you looking for cash flow at your properties? Do you want to push rents? How will leasing staff help determine rents? What weight should property-specific characteristics have?

Having a revenue management tool is not the same as having a revenue management strategy. The tool just automates your strategy. If you can answer the big revenue strategy questions, account for the human factor, and understand the different models, you're ready to rev up your performance with revenue management tools.

Thank you to Yardi Systems for this contribution.

The Weight of Measures

Even as the range and sophistication of revenue management disciplines are on the rise, the integration and adoption of pricing solutions has never been quicker or easier.

Kathie Savage isn't your average multifamily operations manager. True, Savage—the Director of Property Management Operations for Salt Lake City-based Cottonwood Residential—is particular about the technologies adopted across the firm's 34,000-unit portfolio of owned and fee-managed apartment communities, but when she and the executive team at Cottonwood pull the trigger on new technologies, they go all in.

Case in point: Cottonwood's 2012 adoption of revenue management, an overnight sensation rollout of new pricing systems and solutions across 16,000 units. In a single day.

"When you implement in stages, you merely drag out any agonies, and, worse, postpone the benefits," Savage says. "We prefer to work out the kinks beforehand with an extremely small trial group and then implement our properties all at once. When it came to sophistication and pricing, we didn't want to be at the tail end of the deal any longer. We wanted to be revenue management superstars."

Cottonwood Residential is among the multitude of progressive multifamily portfolio owners, operators and property managers that continue to gravitate to revenue management as a critical pricing, lease management and renewal tool. In the three-month period between March and May 2013 alone, one of the industry's revenue management vendors, Rainmaker LRO, signed up more than 30 new clients across a wide range of asset classes and portfolio sizes.

One reason why multifamily firms continue to turn to revenue management systems is the demonstrated gain in effective rent increases. At Cottonwood, some communities saw rents increase by more than 14 percent, and portfolio-wide the firm saw an increase of 4.1 percent.

But firms are also plugging into new applications afforded by advances in optimized revenue management systems, including the opportunity to leverage revenue management mathematics for streamlining the budgeting process or applying next-generation revenue management programming to the student-housing sector.

Balancing the Books

Just introduced at the 2013 NAA Education Conference & Exposition in June, tools for pitting revenue management brawn against the traditionally time-consuming and tedious task of budget building are already in high demand from apartment revenue management professionals. Budgeting tools are allowing firms like Waterton Residential, Simpson Housing and Resource Residential to complete overhaul archaic budgeting practices.

The automated budgeting tools capture key budget and forecasting drivers such as rent charges, move-ins/move-outs, and seasonality, and place them in more user-friendly formats for variance reporting and scenario analysis. Requiring significantly less work than manual or spreadsheet budgeting, revenue management budget tools offer a finer layer of detail to data and the ability to forecast based on unit-category and build-out growth assumptions at the unit level.

"Utilizing a leading revenue management budget tool for the entirety of 2012, our budgeted revenue versus actual revenue improved from 1.47 percent to within .03 percent," explains Simpson Housing Senior Vice President of Revenue Management Bryan Hilton. "It is hard to get your head around what .03 percent actually means. It means the ability to run our entire financial forecast—from operations and marketing to acquisitions and dispositions—with greater accuracy and confidence."

Revenue management technologists are also making significant inroads into the student housing sector, a market with unique lease-up, expiration and supply and demand curves that could often challenge pricing systems built with market rate leasing assumptions in mind.

Intelligent Design, Proven Results

Up next for revenue management is the development of more sophisticated business intelligence (BI) tools and solutions utilizing data warehousing, modeling and integration in addition to predictive analytics and reporting.

With last year's sale of the Archstone portfolio, former Archstone Vice President of Business Intelligence Chris Brust is already consulting with some of the industry's top software companies on how to best deliver BI solutions using revenue management platforms.

"I am excited to help launch into the arena of business intelligence as well as help uncover how data, predictive analytics and more sophisticated reporting can further deliver excellence in pricing practices to revenue management users," Brust says.

But even with all of the latest advanced applications now available to multifamily revenue professionals, the ability of revenue management systems to consistently deliver rent left relative to market is what has nascent and veteran adopters alike lauding the technology.

Cottonwood Residential is looking at an amazing second year with revenue management power under their belt, and has already begun applying optimized revenue management mathematics to renewals in addition to new leases.

"Revenue management takes the emotion out of new pricing, but it's even more important to be able to do that with renewals," Savage says. "When it comes to renewal time, it's extra hard to take emotion out of price increases, increases that are much easier to explain based on the analytics and business sense provided by the components in revenue management. I'm all over that. I love it."

Thank you to Rainmaker LRO for this contribution.

New Uses, New Markets

The flexibility of revenue management systems to work within a variety of lease-up strategies is but one reason that emerging areas of opportunity such as student housing are taking a closer look.

Many in the multifamily industry have yet to realize the tremendous NOI benefits of revenue management on lease ups and renovations. However, true asset optimization will help apartment professionals identify the external and internal drivers that will affect their rents.

"Revenue management is configurable to execute a variety of lease-up strategies, such as quick lease up with lower initial rents or more extended lease up driving maximized rents," says James Flick, Director of Revenue Management for Camden Property Trust, and one of the first to embrace revenue management within a lease-up environment. "Whatever the strategy, revenue management provides the rent recommendations, performance measurement and onsite compliance to navigate through a successful lease up."

But Flick noticed it went beyond that.

"While standard lease ups often involve heavy concessions, revenue managed rents are much closer to true market rents, which down the road will help with retention."

Assisting the Asset Lifecycle

Revenue management platforms have advanced operational control and transparency, and are expanding into budgeting, including revenue forecasting, demand optimization and on-demand analytics.

"Revenue management has transformed from revenue optimization to asset optimization, including demand management, lease transaction-based revenue forecasting and NOI optimization," explains Keith Dunkin, Senior Vice President of YieldStar at RealPage. "Revenue management is really the entrée into a holistic approach to improved asset value through enhanced analytics and cross-platform optimization, maximizing not just rental structure, but the overall DNA and health of the asset."

As transactions have returned to multifamily, revenue management is frequently utilized to protect cash flow while maximizing rents in advance of the sale. In moving to disposition mode, Hale McNinch, Vice President at Bell Partners, ensures his team is configuring revenue management to produce the highest trailing revenues overlaid with maximum near-term rent growth, all the while producing key decision support to substantiate the increased value.

"We consider all components-new lease and renewal rent structures, timing of expirations and upcoming exposure—and optimize the pricing relative to each asset strategy," McNinch says. "At disposition, there is a multiplier of value on each penny of incremental income. Bell Partners is committed to maximizing the sales price for our clients, and revenue management provides us the flexibility and controls required."

Entering the Student Housing Space

Student housing is emerging as a preferred asset class within multifamily housing, and as institutional investment in student housing is expanding, so too is the utilization of revenue management.

Revenue management pioneer LaSalle Asset Management, led by Stephen Adams, Managing Director, was the first to bring revenue management to student housing in 2009.

"We saw the opportunity to leverage science and technology to improve revenues and maximize asset value within our student housing portfolio. Revenue management has done for pricing what institutional investment did for student housing."

When student-housing communities use revenue management, beds are always optimally priced based on the owner's objectives, internal supply and demand characteristics and market conditions.

Additionally, student properties can guarantee a rate as "the best price today," while adding a sense of security by providing them printed quotes. This locks in the rate even if the price on that room increases due to demand. Students are also given a sense of urgency, knowing that the quoted price is only for a limited time. It encourages faster leasing decisions at a better price, which in turn helps communities reach their occupancy goals more quickly and at the highest possible rents.

"Using revenue management on our student housing assets has been key to maximizing revenues," notes Jennifer Cassidy, Vice President at Campus Advantage. "The ability to evaluate the long-term effects of a pricing decision with our revenue management platform is really important to Campus Advantage. When the system makes a pricing recommendation, it will project for you the financial impact to your lease up. For example, if the system recommends a rate increase of $5 on a certain unit type, it will project the potential revenue increase of accepting that rate. Conversely, it might tell you to drop rents by $5, but predict that rate change will yield more leases and thus more revenue."

After nearly a decade of providing the conventional multifamily industry with revenue lifts of 3 percent to 7 percent, the student housing industry is finally taking notice. It's a revenue management trend that owners and operators can no longer afford to ignore.

The near future for revenue management in multifamily housing holds even more opportunity to improve results with enhanced benchmarking, unparalleled insight into how assets are performing relative to the markets in which they compete and in resident retention through optimized rents and lease terms suited to their needs at lease-up, move-in and renewal.

Thank you to RealPage Inc. for this contribution.